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STATE FOR EAP/MTS
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E.O. 12958: N/A
TAGS: EAIR ECON WTRO USTR RP
SUBJECT: Discriminatory Philippine Taxes on Foreign Air Carriers

¶1. (SBU) Summary and Action Request: Northwest Airlines has raised with us concerns about discriminatory taxes levied on foreign air carriers serving the Philippine market. The airline is asking that the Embassy lobby for the abolition of this tax, or for some solution which would mitigate its effects. Post requests that Department review the issue of Philippine taxes on foreign air carriers and inform post whether these taxes in fact violate the international obligations of the Philippines. End Summary.

¶2. (SBU) As Northwest has not wanted to be seen as taking the lead on this issue, it is working through the International Air Transport Association (IATA) to press for changes in the taxation regime. On November 20, we met with officials of Northwest and IATA and received a copy of IATA's November 5 letter to the Philippine Commissioner of Internal Revenue addressing the issue. IATA asserts that the discriminatory tax has contributed to the departure from the Philippine civil aviation market of some foreign carriers, and that others might reduce service here if the issue is not resolved. IATA also suggests that these taxes violate a number of international agreements and may violate others, including bilateral civil aviation agreements. Northwest has requested Embassy assistance to lobby for changes to the Philippine tax regime. Northwest and IATA are currently studying options short of legislative action which might mitigate or resolve the problem. The text of the IATA letter to the Philippine Bureau of Internal Revenue is in para 3 below.

¶3. Text of letter:

5 November 2008
Mr. Sixto Esquivas VI
Commissioner of Internal Revenue
Room 501/511 BIR National Office Bldg
Diliman, Quezon City
Republic of The Philippines

Re: Philippine Taxes on Foreign Airlines

Dear Commissioner Esquivas,

On behalf of IATA and its member airlines operating in the Philippines, I congratulate you on your appointment as the Commissioner of Internal Revenue. We look forward to working with you in close cooperation on challenges and opportunities related to aviation. We respectfully request your urgent engagement with the Executive and Administrative arms of Philippine Government to relieve the punitive and discriminatory taxes imposed on foreign airlines in the Philippines.

We understand that currently, all sales (passenger, cargo, excess baggage and mail) by foreign airlines operating in Philippines are subject to:

¶1. Common Carrier Tax - Under Section 118 (Percentage Taxes on

International Carriers) of the National Internal Revenue Code of the Philippines ("NIRC").
(A) International air carriers doing business in the Philippines shall pay a tax of three percent (3%) of their quarterly gross receipts.
(B) International shipping carriers doing business in the Philippines shall pay a tax equivalent to three percent (3%) of their quarterly gross receipts.

¶2. Gross Philippine Billings - Under Section 28 (A)(3) s of the NIRC:
3) International Carrier. - An international carrier doing business in the Philippines shall pay a tax of two and one-half percent (2 1/2%) on its 'Gross Philippine Billings' as defined hereunder:
"(a) International Air Carrier. - 'Gross Philippine Billings' refers to the amount of gross revenue derived from carriage of persons, excess baggage, cargo and mail originating from the Philippines in a continuous and uninterrupted flight, irrespective of the place of sale or issue and the place of payment of the ticket or passage document: Provided, That tickets revalidated, exchanged and/or indorsed to another international airline form part of the Gross Philippine Billings if the passenger boards a plane in a port or point in the Philippines: Provided, further, That for a flight which originates from the Philippines, but transshipment of passenger takes place at any port outside the Philippines on another airline, only the aliquot portion of the cost of the ticket corresponding to the leg flown from the Philippines to the point of transshipment shall form part of Gross Philippine Billings.
"(b) International Shipping. - 'Gross Philippine Billings' means gross revenue whether for passenger, cargo or mail originating from the Philippines up to final destination, regardless of the place of sale or payments of the passage or freight documents.
We understand the Common Carrier Tax substitutes for VAT which would otherwise be zero-rated on the principle that the services would be consumed essentially outside the country. We further understand the Gross Philippine Billings is essentially an income tax. These taxes apply regardless of whether or not the tickets and airway bills are sold inside or outside Philippines.

Alone these two taxes combined are estimated to directly cost the airline industry in excess of PHP1,880,000,000 a year. Please be informed that International Air Transport Association (IATA) strongly opposes the continued collection of these taxes for the following key reasons:

¶1. Discrimination against foreign operators: The taxes represent a discriminatory tax burden on foreign air operators as the Philippine operators are not subject to the same taxes. The foreign and Philippine operators compete on many international routes and the taxes thus result in an unfair cost advantage for the Philippine operators. This discrimination is clearly counter to General Agreement on Tariffs and Trade (GATT) and now World Trade Organization (WTO) rules and International Civil Aviation Organization (ICAO) resolutions.

Article III.2 of GATT 1947 states that "The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products."

Article 23. iv) of ICAO's Policies on Charges for Airports and Air Navigation Services states that "The charges must be non-discriminatory both between foreign users and those having the nationality of the State in which the airport is located and engaged in similar international operations, and between two or more foreign users."

The discrimination may also be counter to Bilateral Air Services Agreements between the Philippines and your respective country.

The discrimination may also transgress non-discrimination articles in your respective Bilateral Tax Treaties.

¶2. Unjustified Taxation on International Air Transport: Taxes on international services are directly against the International Civil Aviation Organization (ICAO) taxation policies. The ICAO Document

8632, entitled 'ICAO's Polices on Taxation in the Field of International Air Transportation', states: 'Each Contracting State shall ... grant reciprocally ... exemption from property taxes, and capital levies or other similar taxes, on aircraft of other Contracting States engaged in international air transport.'

In addition, ICAO has also adopted a resolution on the taxation of the sale or use of international air transport: 'With respect to taxes on the sale or use of international air transport: each Contracting State shall reduce to the fullest practicable extent and make plans to eliminate all forms of taxation on the sale or use of international transport by air, including taxes on gross receipts of operators and taxes levied directly on passengers or shippers.'

The ICAO resolutions recognize that international air transport involves the use of aircraft and goods and supplies outside any tax jurisdiction. As such, these ICAO resolutions endorse the policy of reciprocal exemption from taxes on aircraft and the elimination of taxes on the sale or use of international air transport. ICAO recognizes that its policy would assure equitable treatment for international aviation throughout the many jurisdictions into which it operates and further enhance the development and expansion of international travel and trade. If the CCT and GBT continue to be imposed on foreign airlines in the Philippines, Philippine based carriers may find themselves exposed to similar taxes imposed in countries around the world where they operate and from which they are currently exempt.

The taxes ultimately lead to an increase in cost of travel and transport. Independent Economics studies have shown that demand for travel is very price sensitive and a 10% increase in airfare can cause up to a 15% reduction in travel demand (Source: Gillen, Morrison & Stewart 'Air Travel Demand Elasticities: Concepts, issues & Measurement'). This damages tourism and redirects foreign trade elsewhere with inherent negative consequences for employment and economic growth. Export costs are also necessarily higher. Such taxes clearly undermine the Philippines' competitive position viz other regional countries and their international aviation services. In addition, it is at odds with the Philippines' commitments under the International Convention on Civil Aviation (the Chicago convention).

These and other taxes have in part or whole caused several foreign airlines to terminate services to Manila in favor of serving other countries with less burdensome tax regimes. Although oil prices have receded recently, foreign airlines' fuel bills remain significantly higher than a year ago. In an industry where margins in a good year fall below these rates of Philippine taxation, one could reasonably expect further reductions in services to the Philippines, in favor of services to neighboring countries. The economic impact to the Philippines due to the loss of these services could greatly exceed the tax currently collected.

IATA endorses the ICAO resolutions on taxation of aircraft and the sale or use of international air transport and requests your assistance to have the Philippine Government urgently revoke these taxes, possibly by substitution of these taxes with VAT, which would be zero-rated, for which a legislative amendment is not required. Airlines believe there are legal grounds upon which to question these taxes and are currently in discussion with taxation experts in Manila on possible legal challenges to this continued discriminatory taxation.

Please do not hesitate to contact us if you need further clarification or assistance.

Respectfully yours,

Vinoop Goel
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Singapore 238164

CC: Department of Tourism, Philippines

Department of Transportation & Communication, Philippines
Department of Trade and Industry, Philippines
Board of Airline Representatives, Philippines

¶3. End text of letter

KENNEY